

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:NJD:NEW:TL-N-5770-98
RABaxer

date: JAN 28 1999

to: Chief, Examination Division, New Jersey District

from: District Counsel, New Jersey District, Newark

subject: [REDACTED]

EIN: [REDACTED]

Tax Period: [REDACTED]

This memorandum has been prepared in response to a review of the disclosure statement filed by [REDACTED] pursuant to it's [REDACTED] Chapter 11 bankruptcy filing. The comments are for your information and you may take whatever action you deem necessary. The memorandum is based upon the facts set forth in the disclosure statement and should be independently verified before taking any action.

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

The [REDACTED] filed a Chapter 11 bankruptcy petition on [REDACTED]. The proposed Plan of Reorganization and Disclosure Statement were previously reviewed by our office and Chief Counsel. There were no objectionable provisions in the Plan of Reorganization.

The review of the Disclosure Statement (hereinafter "DS") indicates that there will be Cancellation of Debt Income ("CODI") as a result of the reorganization. (DS at 48).

Generally, income from cancellation of debt is realized when debt is satisfied for less than the amount owed. Gross income includes income from COD. Section 61(a)(12) and United States v. Kirby Lumber, 284 U.S. 1 (1931).

Section 108 provides exceptions to the general rule that gross income includes income from COD. COD that occurs in a bankruptcy case is excluded from gross income. Section 108(a)(1)(A).

The amount of COD excluded from gross income reduces the debtor's tax attributes in the following order: Section 108(b).

- a. NOL carryovers;
- b. general business credit carryovers (33 1/3 cents for every dollar of COD);
- c. minimum tax credit carryovers (33 1/3 cents for every dollar of COD) (effective for taxable years beginning after December 31, 1993);
- d. net capital loss carryovers;
- e. basis of the taxpayer's property under section 1017;
- f. passive activity loss and credit carryovers (33 1/3 cents for every dollar of COD) (effective for taxable years beginning after December 31, 1993); and
- g. foreign tax credit carryovers (33 1/3 cents for every dollar of COD).

_____ says it expects to report a NOL carryforward of \$_____ as of _____. (DS at 48). The taxpayer indicates that the CODI it will experience in this current Chapter 11 case will substantially reduce or eliminate its NOL carryforwards as of _____ and it's NOL for _____. (DS at 48, 27).

The CODI results from the Reorganization Plan's payment of \$_____ of principal _____ Notes with common stock of the reorganized debtor, which it estimates will be worth \$_____. (DS at 11).

A simple math calculation ($\$ \blacksquare - \$ \blacksquare = \$ \blacksquare$) shows a predicted CODI of $\$ \blacksquare$ solely from the Reorganization Plan's treatment of the "principal" of the \blacksquare Notes. (Whether there is also CODI from the Plan's treatment of unpaid interest on the \blacksquare Notes may depend on whether \blacksquare accrued and claimed tax deductions for such unpaid interest.)

If \blacksquare 's estimate of the value of its common stock given to the \blacksquare Notes is too high, then its CODI resulting from the Plan of Reorganization would increase correspondingly. (DS at 48).

The valuation of the new common stock is not an issue that the Service would want to litigate or see determined at confirmation of the bankruptcy. Instead, Examination may want to inspect \blacksquare 's \blacksquare tax return to be sure that an appropriate reduction of NOL carryovers and other tax attributes is reflected to account for the effects of the Plan of Reorganization.

We have attached a copy of the Disclosure Statement for your information.

If you have any questions or need further information, please contact Robert A. Baxer at (973) 645-2598.

 /s/
PATRICK E. WHELAN
Assistant District Counsel

NOTED:

 /s/
MATTHEW MAGNONE
District Counsel

Attachment:
Disclosure Statement